

TELECOMMUNICATIONS

The competitive environment in important parts of Japan's telecom sector has dramatically evolved over the past several years as the Japanese Government's efforts to promote policy and regulatory reform have begun to yield positive results. This is evident in the roll-out of numerous innovative technologies and competitively-priced advanced services, including Digital Subscriber Line, Fiber-to-the-Home, and Voice Over Internet Protocol. Revisions to the Telecommunications Business Law (TBL), which came into effect from April 2004, also improved the competitive conditions for this sector.

While requirements for competitive carriers have been eased significantly, the United States believes that the Ministry of Internal Affairs and Communications (MIC) should redouble its efforts to strengthen dominant carrier regulation and competitive safeguards. Without such steps, it remains difficult for competing carriers (both domestic and foreign-invested) to offer attractive alternatives to NTT's regional carriers and mobile operator. Furthermore, greater transparency and accountability is needed to ensure that decisions do not unfairly skew the regulations in favor of the incumbents. MIC could also greatly improve the competitive environment through a more transparent and pro-competitive approach to advanced wireless services, particularly relating to spectrum, in both licensed and license-exempt areas.

Building on the progress achieved in the previous year, the United States suggests that the Telecommunications Working Group continue to invite experts from government and the private sector to provide their perspectives on new and mutually important issues. In addition, the United States recommends that Japan implement the following reforms:

SUMMARY OF RECOMMENDATIONS

- **Regulatory Independence:** Take steps to transfer regulatory functions to an independent agency not under ministerial authority, and end MIC's control over NTT's business decisions.
- **Mobile Termination Rates:** Investigate if rates for termination to the NTT DoCoMo network are set at reasonable, competitive levels, and ensure competitive neutrality in retail rate setting.
- **Transparency and Accountability:** Increase public participation in MIC's regulatory and policy decisions, and adopt measures to facilitate reconsideration and judicial review of regulatory decisions.
- **Spectrum Policy:** Ensure that Japan's spectrum management policies and practices (such as licensing, allocation, testing, and fees) are more transparently administered, promote greater innovation, competition, and efficient spectrum use (in both the licensed and license-exempt areas), and adhere to technology-neutral principles.
- **Strengthening of Competition Safeguards:** Bolster dominant carrier safeguards to prevent abuses by carriers with market power.
- **Equipment Certification:** Conclude a Mutual Recognition Agreement between the United States and Japan that would facilitate more efficient trade in telecommunications products.
- **Wireline Interconnection:** Address structural flaws in the 2003-2004 interconnection rate methodology, with the aim of encouraging cost-oriented and reasonable interconnection rates that promote efficient competition.

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I. Strengthening Regulatory Independence and Promoting Greater Transparency.

The Ministry of Internal Affairs and Communications (MIC) has long had difficulty shielding the regulatory decision-making process from partisan influences. Previous decisions that have benefitted larger companies with histories of government ties, at the expense of new entrants, underscore the critical need for measures to bolster regulatory independence and accountability.

A. To foster regulatory independence the United States urges Japan to:

1. Develop a plan for moving regulatory functions from the purview of a ministerial agency subject to direct political control to a fully independent organization;
2. Eliminate any requirement that the Japanese Government own a specified amount of NTT shares and that foreign shareholding or a management role be restricted;
3. Eliminate ministerial interference in management operations of NTT, including business plans and personnel decisions;
4. Establish and exercise meaningful sanction authority by the regulator (imposition of fines, payments of damages, license restrictions) to punish anti-competitive behavior; and
5. Take interim steps towards achieving these goals that would include:
 - a. Implementing measures to strengthen the operation, effectiveness, and purview of Japan's Dispute Resolution Commission, including steps to maximize transparency in dispute settlement actions; and
 - b. Instituting clear firewalls between industrial promotion and regulatory oversight, to ensure that specific companies benefiting from MIC industrial promotion programs are not granted privileged regulatory treatment.

B. To foster greater regulatory accountability, the United States urges Japan to take concrete steps to facilitate reconsideration and judicial review of regulatory decisions, and ensure that the regulator and the courts have the resources to address such issues effectively within a reasonable time frame. Specifically, this should include:

1. Adopting and publishing transparent procedures to ensure that a full, public record supporting decisions and determinations is available, and

that special interests are not accorded privileged access to the regulatory process; and

2. Opening the selection process for MIC-sponsored study groups such that any interested stakeholders are given the opportunity to participate.

II. Network Access and Promotion of Competition. With the revision of the Telecommunications Business Law in April 2004, Japan achieved significant progress in deregulating competitive carriers. Competitors' access to bottleneck facilities, however, remains essential to promote both facilities-based and service-based competition, which are key Japanese Government goals. MIC can take further steps to ensure competition in the telecommunication sector by strengthening dominant carrier regulation, reducing interconnection rates for wireline services, and other measures that improve the competitive environment.

A. Dominant Carrier Regulation and Competition Safeguards. The United States recommends that Japan ensure that regulations and ministerial ordinances under the revised Telecommunications Business Law retain obligations specific to carriers with a dominant position in Japan's market and give the appropriate entity the authority to enforce these obligations. In particular, the United States urges Japan to:

1. Identify by March 2005 all markets and sub-markets for review of market power and appropriate remedies and establish an accelerated schedule for all such reviews, taking into account relevant experience of policy makers and regulators in other markets, such as in the EU;
2. Ensure in law and/or regulation that access to poles, ducts, conduits, and rights of way is non-discriminatory and cost-based, and provide transparent pricing methodology for such access;
3. Establish methods for evaluating pricing abuses by dominant suppliers (e.g. imputation tests) for voice as well as data services;
4. In the annual review of whether NTT East and West are complying with the parameters governing expansion into new lines of businesses, publish quantitative data relating to network access and treatment accorded competitors;
5. Institute transparent means, based on information to be made publicly available, for evaluating whether NTT East and West leased lines used by competitors are offered at reasonable, competitive rates;
6. Consider rules (e.g. separate affiliate transaction rules) to ensure that a dominant supplier does not use revenues from a regulated service to subsidize a non-regulated service in an anti-competitive manner;

7. Develop competition-related performance metrics, including reporting requirements, and financial penalties for missing such metrics. Such metrics should ensure that a dominant carrier treats competitors no less favorably than it treats itself or its affiliates in matters such as provisioning, quality of service, and repair and maintenance of all network services and facilities needed by competitors; and
8. Ensure that dominant carriers seeking to expand the scope of their services outside their traditional monopoly services be subject to appropriate safeguards to ensure that dominant position in one market is not leveraged with anti-competitive effects.

B. Wireline Interconnection. In July 2004, the Information and Communication Council released for public comment a proposal for restructuring the interconnection rate model (known as Long-Run Incremental Cost, or LRIC), which would be applicable for three years starting in FY2005. The United States welcomes the proposal as a step in the right direction towards reducing interconnection rates to acceptable levels, and looks forward to the release of the revised proposal in October 2004, which should reflect the comments received from various stakeholders. The United States urges MIC to take into serious consideration the following recommendations as it drafts the ordinances to implement the revised model:

1. *Elimination of NTS Costs*. The United States urges Japan to eliminate non-traffic sensitive (NTS) costs from the metered interconnection rates from FY2005, without a phase-out period.
2. *Review of NTT's Basic Charge*. Given the decision of NTT's two regional carriers to reduce their basic monthly charge by up to 490 yen, MIC should require NTT East and West to document, in a transparent, publicly verifiable manner:
 - a. Precisely which costs are currently recovered from monthly subscriber line charges;
 - b. Why recent basic monthly charge reductions on retail services, combined with wholesale (interconnection) rate increases are not predatory or exclusionary;
 - c. Why wholesale monthly charges (dry copper) ought not be reduced proportionately to retail rate reductions;
 - d. How costs associated with basic monthly charges are identified and allocated between different services (e.g. ISDN, DSL, leased lines etc.); and

- e. The assumptions behind basic line cost recovery, including *inter alia* cost recovery already achieved through initial subscriber line charges (*kanyu kenri* or *shisetsu secchi futankin*), depreciation rates and methodologies used, and allowable profit margins.
3. *Elimination of Subsidy Between NTT East and West.* The United States urges Japan to:
- a. Require NTT East and West to each set a cost-oriented interconnection rate, consistent with Japan's WTO obligations, taking into account differing costs of the respective regions; and, as necessary, permit differential interconnection rates between the regional carriers, taking into account dangers of (and methods to prevent) anti-competitive price squeezes; and
 - b. Eliminate the current use of interconnection revenue as a source of cross-subsidization between NTT East and West, and require that any such subsidies, if demonstrated to be necessary, be paid out of a competitively-neutral universal service fund.
4. *Adapting to New Market Conditions.* As the structure of Japan's wireline communications sector continues to undergo significant changes brought on by competition and innovation, the United States urges Japan to:
- a. Consider transitioning to a bill-and-keep cost-recovery mechanism for as broad as possible a range of network access functions; and
 - b. Ensure that carriers can request assistance from the Telecommunications Business Dispute Settlement Commission to resolve disputes regarding negotiated interconnection for voice calls carried between analog systems and IP-based networks, as well as between carriers providing IP-based voice telephony, taking into account the market power of dominant carriers.

C. Mobile Termination Rates. The United States urges Japan to:

- 1. In accordance with Japan's Telecommunications Business Law and Japan's 2002 commitment to ensure competitive interconnection rates for dominant wireless networks, institute an objective and transparent means for evaluating whether mobile wireless termination rates are set at cost-oriented levels, and to provide a basis for arbitration if commercial negotiations fail;
- 2. For wireline carriers seeking to interconnect with mobile operators, institute competitive neutrality by eliminating the default right of mobile carriers setting the retail rate; and

3. In addition to analyzing NTT DoCoMo's dominant position in the mobile sector, analyze the degree to which all mobile carriers exert market power in the sub market for call termination.
- D. Promotion of Competition in the Mobile Sector. Given the high degree of concentration in Japan's mobile market, and high consumer prices, the United States urges Japan to consider expanding opportunities for additional mobile operators to enter this market, including in the 2010 and 800 MHz bands. Where incumbent operators are underutilizing spectrum, or are in the process of moving subscribers to new services in different spectrum, MIC should consider re-allocating older spectrum to other operators on a technology-neutral basis.
 - E. Deregulation of Digging Regulations. Institute a review of all digging regulations, based on a public comment process, with a view to identifying which rules can be relaxed or eliminated to help reduce the cost and time involved in installing new telecommunications infrastructure.
 - F. Unbundling. Prior to eliminating any unbundling requirements, conduct a market review based on competition policy principles, incorporating public comments, to evaluate relevant instances of market power and bottleneck control.
 - G. Non-Discrimination in Service Quality. For facilities where unbundling is required, the United States urges Japan to require NTT East and West to:
 1. Include among their interconnection terms and conditions a service level agreement (SLA) similar to those offered to retail customers, specifying the period within which NTT East and West must respond to a disruption or deterioration of service; and
 2. Permit wholesale customers the option of maintaining facilities themselves, subject to reasonable access to such facilities.

III. Measures to Promote Advanced Wireless Technologies and Services. In its 2004 White Paper, "Building a Ubiquitous Society That Spreads Throughout the World," MIC described how broadband and wireless technologies are converging in Japan to create "ubiquitous networks that allow anyone to connect to networks at anytime from anywhere and exchange information freely." Furthermore, in August 2004, MIC announced that its FY2005 ICT policy will focus on the "u-Japan" paradigm. Consistent with these goals, the United States recommends that Japan adopt more flexible approaches to spectrum regulation in order to promote innovation, competition, transparency, and efficient spectrum use. Specific recommendations include:

- A. Flexible Use of Licensed Spectrum. To encourage more efficient and innovative use of spectrum, the United States recommends that Japan:

1. Take steps to facilitate the ability of licensed operators to lease, sub-lease, and exchange spectrum with other service providers; and
 2. Institute a clear policy of technology-neutral licensing, separating, to the maximum extent possible, operator choice of technology from the spectrum assignment and service license process.
- B. Spectrum Allocation For New Technology. The United States urges Japan to
1. Begin identifying and allocating spectrum that can be used for innovative wireless LAN technologies, fixed and mobile MAN services and other non-standardized technologies; and
 2. Consider, where feasible, making spectrum available for such technologies on an unlicensed or “license-exempt” basis.
- C. Testing Procedures For New Technologies. Review procedures for obtaining test licenses with a view to streamlining the process, making it more transparent, and establish procedural safeguards that prevent incumbent companies from hindering the testing of competing technologies.
- D. Spectrum User Fee System. As MIC reviews the proposal by the Study Group on Policies Concerning the Effective Radio Spectrum Use, and finalizes its decision, the United States urges MIC to:
1. Refrain from imposing user fees on license-exempt devices and services; and
 2. Refrain from introducing new forms of spectrum exclusivity for license-exempt devices until non-exclusivity options have been thoroughly and transparently examined.
- E. Spectrum Use by Unlicensed Low-Power Devices. The United States urges the Japanese Government to ensure a timely, objective, and transparent process for the deliberation of regulatory changes in FY2004 and thereafter that would allow use of spectrum on license-exempt basis for low-power RFID devices, taking into consideration interests of existing users in the relevant bands.
- F. Private Sector Input. The United States looks forward to enhancing the Telecommunications Working Group dialogue by inviting experts from government and the private sector as guest speakers to share their views.

IV. Promotion of Trade in Telecommunications Equipment. To facilitate more efficient trade in telecommunications and IT products, both the United States and Japan have taken steps to facilitate mutual recognition of testing and certification requirements. In this spirit, the United States proposes that through the Telecommunications Working Group,

the Governments of the United States and Japan conclude a Mutual Recognition Agreement (MRA) for requirements relating to telecommunications equipment specifically, and electro-magnetic compatibility (EMC) generally by the end of FY2004.